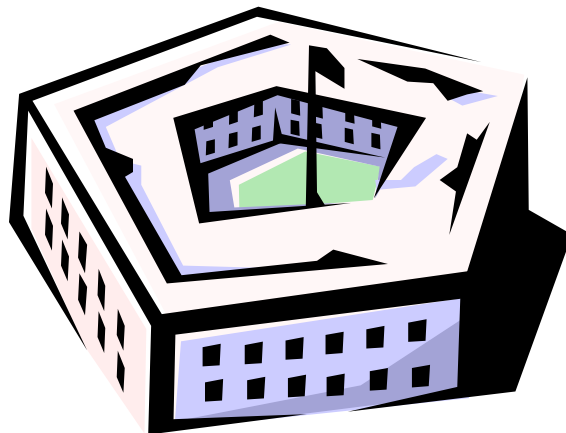




FY 2005 Defense-Wide Conference

Department of Defense (DoD) Management Control Program



*Peggy P. Johnson
Department of Defense
Management Control Program Coordinator,
Office of the Deputy Chief Financial Officer*



Agenda

- *Examples of why internal controls are important*
- *Definition of management and internal controls*
- *What can happen if controls are ineffective*
- *Revised Office of Management and Budget requirements*
- *How we did in FY 2004*
- *Metrics and goals (financial versus non-financial weaknesses)*
- *Material and systemic weaknesses reported FY 2004*
- *New revised reporting format*



Management Control References

➤ **DoD Website:**

<http://east.defenselink.mil/comptroller/fmfia/index.html>

➤ ***Federal Managers Financial Integrity Act of 1982
(PL 97-255)***

➤ ***GAO Standards for Internal Control in the Federal
Government, November 1999***

➤ ***OMB Circular A-123, Management's Responsibility for
Internal Control, December 21, 2004***

➤ ***DOD Directive 5010.38, Management Control Program,
August 26, 1996***

➤ ***DOD Instruction 5010.40, Management Control Program
Procedures, August 28, 1999***



Remember Ranger Training Catastrophe?

ranger Training

Four died

Hypothermia



Ineffective Internal Controls on Safety



Remember the Corporate Scandals?

corporate



SCANDALS

SARBANES OXLEY ACT OF 2002



What links these events? – Ineffective Internal Controls





Management Controls Same as Internal Controls

Management Controls = Internal Controls

↑
*government
term*

↑
*industry
term*



What is a System of Management or Internal Controls?

- ***Management (internal) controls are the process that helps ensure mission objectives are met:***

- ***Helps ensure accountability***
- ***Does not guarantee success or ensure against waste, fraud, or mismanagement, but helps mitigate RISK***



- ***Three objectives of internal controls:***

- ***Effective and efficient operations***
- ***Reliable financial reporting***

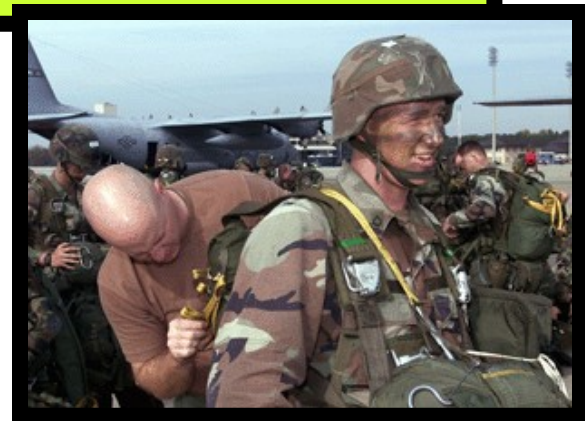


Example

Mission Objective: Obtain proficiency in parachuting with

Possible Risk: Parachute fails to open properly due to incorrect packing.

Internal Control Activity: Final safety check of parachute rigging.





Examples of Management or Internal Controls Activities

Wearing chemical gloves during Nuclear, Chemical & Biological skills challenge



✓ ***Tape that balances by denomination for cashier transactions***



✓ ***Person accounting for funds cannot disburse funds - Separation of duties***



✓ ***Certifying fund availability before obligating funds***

✓ ***Inflatable rafts designed to arrest hypothermia during Ranger rope building training exercises***





Federal Managers' Financial Integrity Act

Heads of Agencies will:

- ***Establish an effective system of internal controls***
- ***Assess the effectiveness of internal controls***
- ***Annually report assurance to the President and Congress***
 - ***Identify material weaknesses***
 - ***Identify plan and schedule for correcting***

• **(Unqualified)** - “reasonable assurance that management (internal controls) are in place, effective, and being used.”

• **(Qualified)** - “reasonable assurance that management (internal controls) are in place, effective, and being used *except for...*”

• **(Negative statement)** - “does not provide reasonable assurance.”





Material Weaknesses Should Be Priority to Resolve

Resolving deficiencies must be a priority

- Make realistic targeted projections*
- Ensure leaders are aware of urgency to resolve*
- Put resources on accomplishing the corrective actions*
- Do not report as resolved if significant outstanding
audit recommendations remain open!*



*On time resolution demonstrates to OMB,
Congress, and the President, DoD's
commitment to stewardship!!*



OMB CIRCULAR A-123 (REVISED)

- *Prescribes policy to comply with Federal Managers' Financial Integrity Act*
 - *Defines management (internal) controls as:*
 - *Process that helps managers achieve results and safeguard integrity of programs*
 - *Helps reduce risk of fraud, waste, and abuse*
 - *Requires Heads of agencies to:*
 - *Conduct risk assessment and establish internal controls*
 - *Assess effectiveness of internal controls*
 - *Report assurance in effectiveness of internal controls*
 - *Identify, correct and report material weaknesses*
- *Recently changed to strengthen the requirements for assessing internal controls over financial reporting in the APPENDIX A*



How Did We Do in FY 2004?



DoD Statement of Assurance is Part of Performance and Accountability Report

- **Annual report submitted to the President, Congress, and OMB by federal agencies**
- **The PAR contains:**
 - *DoD's annual statement of assurance*
 - *DoD's annual performance report*
 - *DoD's annual audited financial statements*
 - *An overview of the Defense Strategy and Policy Objectives*
 - *The status of DoD's Compliance with certain Laws and Regulations*
 - *A summary of the Department's progress on achieving the President's Management Agenda*
 - *IG's summary of management challenges*
- **Accelerated Reporting Date - November 15**



FY 2004 DoD Statement of Assurance

- The Message from the Deputy Secretary of Defense says:

"...The Department is committed to effective internal controls, full compliance with established guidelines and standards, and proper stewardship of the resources entrusted to it. During fiscal year 2004, we corrected 11 management control weaknesses, and except for the unresolved weaknesses noted in the Management Discussion and Analysis section (Part 1) of this report, the Department has reasonable assurance that its management controls are effective. The Department will continue its efforts to resolve the remaining issues and I am confident that the Department will continue to fulfill its mission responsibilities...."



Weaknesses Reported in the FY 2004 PAR

Financial and Non-Financial



***40 Weaknesses Beginning FY
2004***

+17 New Weaknesses

- 11 Corrected

***46 Weaknesses Ending FY
2004***



Financial Weaknesses FY 2004 Compared to FY 2003



***17 Weaknesses Beginning FY
2004***

+ 5 New Weaknesses

- 5 Corrected

17 Weaknesses Ending FY 2004



Delinquent Weakness

"DELINQUENT WEAKNESS"

Any weakness:

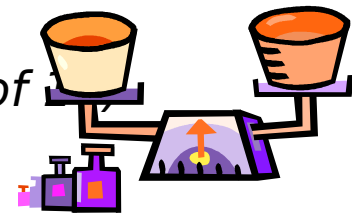
- *Reported in FY 1999 or before*
- *Failed to meet targeted correction more than once*
- *Revised targeted correction date is three years past the original correction date*
- *Targeted correction dates too vague to determine intent, i.e., "to be determined."*





Department of Defense Performance Goals

- *Metric = # (%) material / system weaknesses resolved*
- *Financial Goal = zero material or systemic weaknesses by FY 2007*
 - *In FY 2004:*
 - » *Although corrected 5 of 11 as projected (45%); 5 new were added*
 - » *Began with 17 and ended with 17*
 - » *No improvement toward goal of zero weaknesses by FY 2007*
- *Non-Financial Goal:*
 - *100% of systemic and material weaknesses resolved as projected*
 - *Reduce delinquent weaknesses to zero*
 - *In FY 2004 :*
 - » *Only 43% were corrected as projected (6 of*
 - » *One systemic and five material corrected*
 - » *Delinquent weaknesses remain open*
- *Department encourages full disclosure*
- *And we must promptly resolve weaknesses as projected*



Please be realistic on targeted projections!



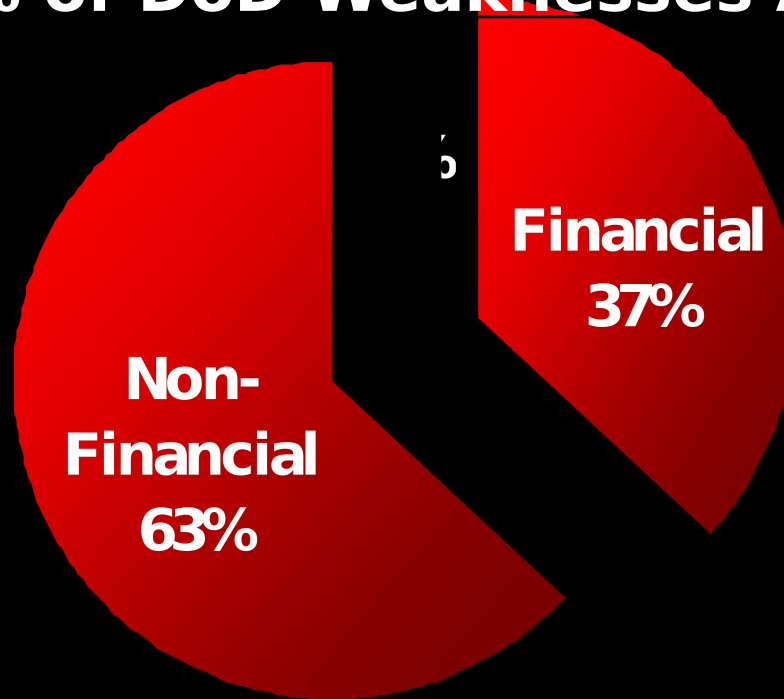
Reported Material & Systemic Weaknesses

- ***(37) Material Weakness reported FY 2004-***
 - *Are weaknesses in management controls*
 - *Usually affect a single DoD Component*
- ***(9) Systemic Weaknesses reported FY 2004-***
 - *Are weaknesses in management controls*
 - *Across organizational and program lines*
 - *Usually affect multiple DoD Components*



Percentage of Weaknesses That Are Non-Financial

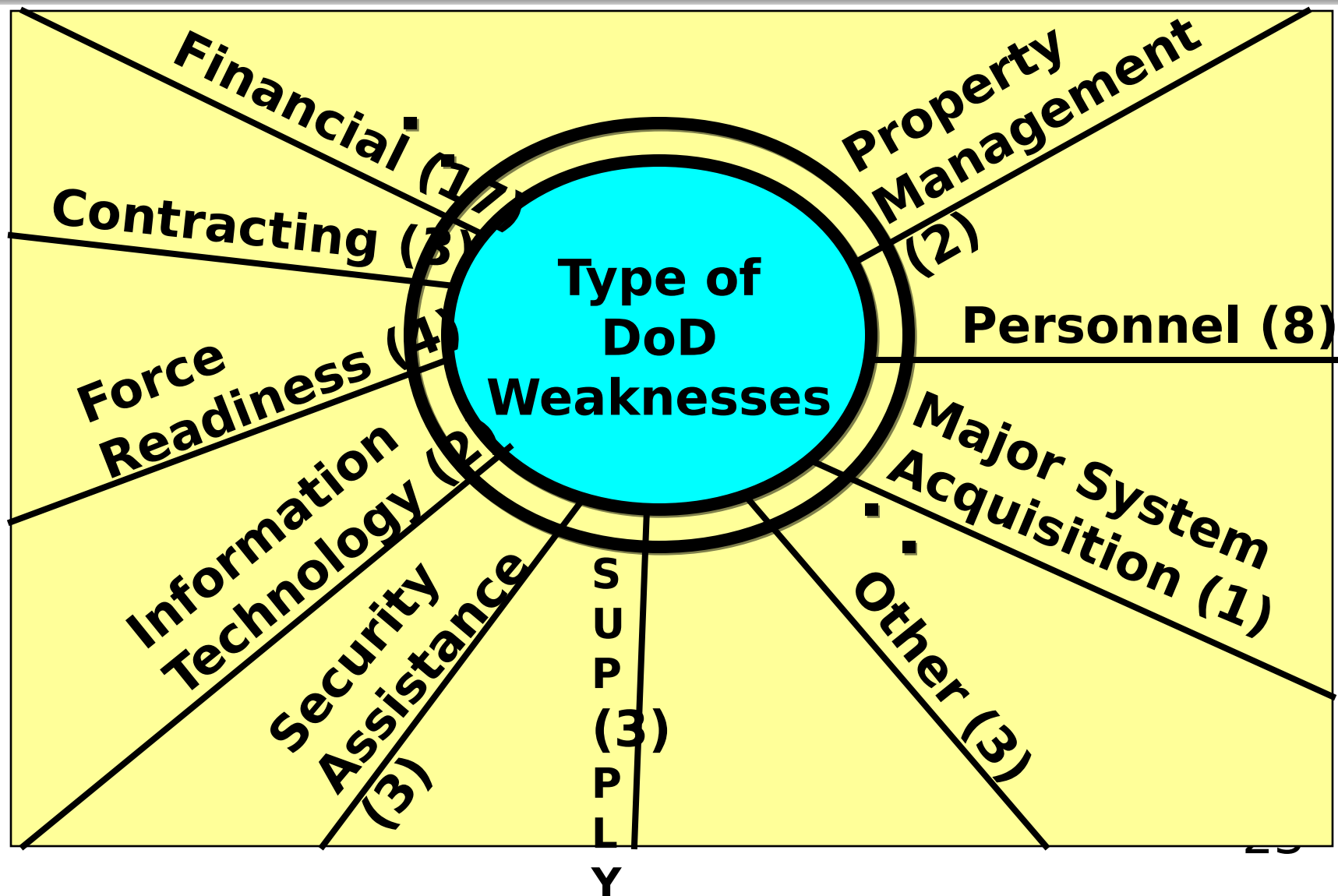
Over 50% of DoD Weaknesses Are Non-Financial



FY 2003 - 57% Non-Financial / 43% Financial



DoD Weakness Areas





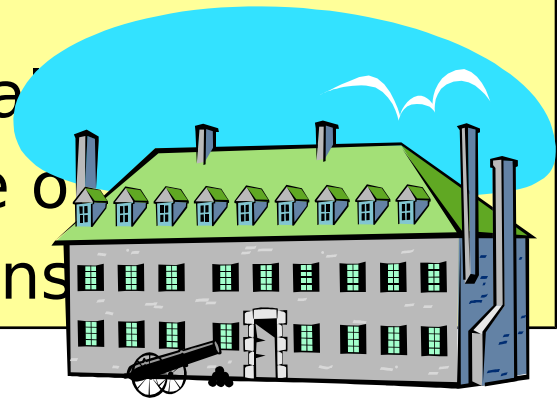
Examples Financial Systemic Weaknesses

	# Consolidated	# Components Reporting
DoD Financial Mgt Systems & Processes	15	12
Environmental Liabilities	2	2
Government Card Program Management	4	3
Valuation of Plant, Property & Equipment on Financial Reports	11	5



Examples of Non-Financial Systemic Weaknesses

- Personnel Security Investigations Program
 - Backlog is adversely affecting DoD hiring
- Real Property Infrastructure
 - Not adequately managed to have deterioration or obsolescence of facilities on military installations





New Format in the FY 2004 Annual Assurance Statement

Table III. Section 2 Material Weaknesses - Ongoing

Non-Financial Material Weaknesses (Continued)	Major Corrective Action(s) <i>A sample of the actions is presented.</i>	Indicates Complete d or Mileston e Date
17. The Russian Federation failed to honor commitments associated with the Cooperative Threat Reduction Program. (Defense Threat Reduction Agency)	✓ The Russian Federation has signed the amendments for storage security, weapons transportation security, and chemical weapon elimination.	Completed Qtr/FY
First Reported: FY 2002	✓ Work with Russian Federation to ensure plans are prepared for further reduction of nerve agents.	3 rd / 2005
	✓ Validate that the weakness is corrected.	3 rd / 2005
	Correction Target Date: 3rd Quarter, FY 2005	26



New Format in the FY 2004 Annual Assurance Statement (cont)

Title	9. Improper Use of Non-Department of Defense Contracting Vehicles
Description of Issue	Non-Department of Defense contracting vehicles have been used improperly to procure services or supplies. (Newly reported: FY 2004)
Progress to Date	<p>A. Completed Milestones for FY 2004:</p> <ul style="list-style-type: none">• Developed and coordinated guidance.• Developed training.• Conducted outreach programs with assisting civilian agencies. <p>B. Planned Milestones for FY 2005:</p> <ul style="list-style-type: none">• Issue policy memorandum.• Issue interim rules in the Defense Federal Acquisition Regulation Supplement.• Initiate workforce training.• Begin obtaining reports on the Department of Defense use of non-Department of Defense contracts from assisting civilian agencies. <p>C. Planned Milestones for Beyond FY 2005:</p> <ul style="list-style-type: none">• Complete the compliance review regarding the implementation of the policies for proper use of non-Department of Defense contracts



Establish Effective System of Internal Controls & Help Prevent Things that Go Wrong



**Friendly Fire Destroys
Blackhawk
Helicopters Over Iraq**



Summary

Establishing a system of internal controls makes sense because it helps the Department of Defense establish:

- *Processes that work (effective and efficient)*
- *Produce reliable financial information*
- *Comply with laws and regulations*



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